Q1 2024 Tapestry Inc Earnings Call - Final

FD (Fair Disclosure) Wire

November 9, 2023 Thursday

Length: 10965 words

Body

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Presentation

OPERATOR: Good day, and welcome to this Tapestry Conference Call. Today's call is being recorded.

(Operator Instructions) At this time, for opening remarks and introductions, I would like to turn the call over to the Global Head of Investor Relations, Christina Colone.

CHRISTINA COLONE, GLOBAL HEAD OF IR, TAPESTRY, INC.: Good morning. Thank you for joining us. With me today to discuss our first quarter results as well as our strategies and outlook are Joanne Crevoiserat, Tapestry's Chief Executive Officer; and Scott Roe, Tapestry's Chief Financial Officer and Chief Operating Officer.

Before we begin, we must point out that this conference call will involve certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. This includes projections for our business in the current or future quarters or fiscal years. Forward-looking statements are not guarantees, and our actual results may differ materially from those expressed or implied in the forward-looking statements. Please refer to our annual report on Form 10-K, the press release we issued this morning and our other filings with the Securities and Exchange Commission for a complete list of risks and other important factors that could impact our future results and performance.

Non-GAAP financial measures are included in our comments today and in our presentation slides. For a full reconciliation to corresponding GAAP financial information, please visit our website, Www.tapestry.com/investors, and then view the earnings release and the presentation posted today.

Now let me outline the speakers and topics for this conference call. Joanne will begin with highlights for Tapestry and our brands. Scott will continue with our financial results, capital allocation priorities and our outlook going forward. Following that, we will hold a question-and-answer session, where we will be joined by Todd Kahn, CEO and Brand President of Coach. After Q&A, Joanne will conclude with brief closing remarks. I'd now like to turn the call over to Joanne Crevoiserat, Tapestry's CEO.

JOANNE C. CREVOISERAT, PRESIDENT, CEO & DIRECTOR, TAPESTRY, INC.: Good morning. Thank you, Christina, and welcome, everyone. As noted in our press release, we achieved record first quarter earnings per share as we meaningfully advanced our strategic priorities against the dynamic external backdrop. Our consistent progress demonstrates the power of brand building, customer centricity and disciplined execution, which enable us to fuel innovation and cultivate new and lasting relationships with consumers around the world.

I want to thank our talented global teams for their passion and unwavering focus, which continue to drive our strong and differentiated results. Touching on the strategic and financial highlights for the quarter. First, we powered global growth, achieving 2% constant currency revenue gains consistent with our outlook and underscoring the benefits of our globally diversified business model. This top line growth was fueled by a 7% gain internationally, which included a 9% increase in Greater China, again surpassing our peak in FY '21. In addition, our business with Chinese consumers globally rose low double digits, supported by improving tourist trends in Asia and Europe.

Looking ahead, while the consumer environment in China continues to be volatile, we remain committed to investing behind our brands leveraging Tapestry's established platform in the region to drive long-term growth, both in China and with this important consumer cohort worldwide. Turning to Japan. We drove continued momentum with revenue rising 12%. And in other Asia and Europe, sales were relatively in line with the prior year. Finally, in North America, we delivered revenue roughly in line with last year and consistent with our expectations.

Despite the challenging consumer backdrop in the United States, we are driving a healthy business, underscored by significant growth and operating margin expansion compared to last year. Second, we remain focused on

building customer engagement across our brands, harnessing the power of our data-rich platform. In the quarter, we acquired over 1.2 million new customers in North America alone of which roughly half were Gen Z and millennials, as we advance our strategy to attract younger consumers to our brands. Importantly, we continue to see new customers transact at a higher AUR than the balance of our customer base.

Third, we delivered unique and seamless omnichannel experiences, reinforcing the benefits of our operating model. We drove growth in direct-to-consumer sales on a constant currency basis, including a low single-digit gain in brick-and-mortar sales supported by our world-class field organization and a store fleet that is proven and highly profitable. In addition, we maintained our strong positioning in digital, leveraging our established capabilities to connect with consumers across their purchase journey. While sales declined slightly, revenues still represented nearly 25% of sales, approximately 3x pre-pandemic levels. Fourth, we fueled fashion innovation and product excellence delivering compelling newness and value to customers around the world with success in new launches and bring elements outperforming expectations and fueling handbag AURs globally. At the same time, we delivered outsized top line gains in our small leather goods and lifestyle offerings, key to enhancing brand relevance and fueling customer lifetime value.

Taken together, we generated record first quarter earnings per share, increasing at a high teens rate compared to the prior year, which we accomplished despite a volatile demand backdrop. Our strong and consistent results reinforce the power of our brands and strategies amplified by the advantages and agility of our model. As we look forward, we remain laser-focused and confident in our ability to drive sustainable, profitable growth.

Now turning to the highlights across each of our brands, starting with Coach. Our team continued to bring expressive luxury to life building the brand through emotional consumer connections, innovation that encourages self-expression and immersive omnichannel experiences. These strategies are driving sustainable momentum and exceptional financial results highlighted by 5% constant currency revenue growth and 180 basis points of operating margin expansion, supported by strong gross margin gains.

Touching on some details of the quarter. First, we fueled growth in our leather goods offering by leaning into our iconic platforms. We reinforced our key families, including Tabby, Willow and Rogue through a continued focus on core styles while animating the icons to drive excitement. Tabby again outperformed expectations, nearly doubling versus last year, with strength across bags and small leather goods at strong AUR relative to the balance. We're continuing to iterate on this icon, including a new size in our shoulder bag, which over-indexed with the younger consumer as well as a braided option of our soft style. Overall, Tabby remains an important volume and recruitment driver for the brand, and we see even further runway ahead.

At the same time, Willow and Rogue remained important volume drivers within the assortment. In keeping with consumer trends, we also launched new silhouettes across a range of price points and sensibilities, including the idle shoulder bag, which was a notable highlight in Greater China, where AUR was well ahead of the average. Overall, our creative and innovative products supported a mid-single-digit gain in global handbag AUR at constant currency, including growth in North America. Importantly, we see continued runway for pricing improvements given our innovation pipeline and brand heat. Second, we delivered gains across lifestyle, an area of long-term opportunity for the brand. We drove top line growth in ready-to-wear, footwear and men's as we develop our core families with a goal of driving customer recruitment, purchase frequency and ultimately, customer lifetime value. In ready-to-wear, we focused on our strategy of building a timeless assortment of key styles that represent a compelling value. This included the successful launch of our snap front leather jacket at a $695 price point as well as success in our evergreen trench coats.

In footwear, the Leah Loafer remained a top seller and delivered significant growth. And in men's we delivered outsized gains driven by the performance of our relay tote, which was again a top style while the newly introduced Beck family of sporty and sophisticated options also delivered strong results. Third, we created purpose-led storytelling directly tied to our product. We began the quarter with the debut of our third purpose campaign Wear Your Shine which inspires consumers to express themselves authentically using fashion as a means for personal expression and empowerment. The Shine collection includes metallic and sparkle bags, ready-to-wear and accessories allowing customers to shine brightly.

Our campaign featured new global ambassadors, including Dove Cameron and Youngji Lee. We brought the campaign to life through experiences across the world with physical and digital activations from campus takeovers in the U.S. to a partnership with Vogue world in Europe to pop up installments across Asia. Overall, the success of this campaign helped to support the acquisition of approximately 800,000 new customers in North America including a growing number of millennials and Gen Z. Fourth, we focused on deepening connections with consumers by further developing our customer insights capabilities to build stronger and longer-term connections. In keeping with this strategic pillar, we launched a trial on Amazon in September. The platform provides broad consumer reach and plays a vital role in the customers' discovery and purchase journey, specifically for young cohorts.

And finally, we built momentum in our subbrand Coachtopia, a reimagination of the product creation process to evolve our vision of circularity. We expanded our reach in North America while launching in Japan with additional international opportunities in the pipeline. We've also further innovated across the assortment, including our Coachtopia Loop collection designed with a mono material approach, recycled PET plastic. While Coachtopia remains a small portion of the assortment, we are very excited by the significant consumer attention, specifically with younger audiences.

Looking ahead to holiday. We're continuing to focus on building stronger emotional connections with our consumer base while prioritizing brand health, and we remain disciplined in our approach to discounting in an increasingly promotional environment. We're bringing our purpose to life, delivering an emotional narrative through our more than a gift holiday campaign, which celebrates the gifts that give us confidence to be ourselves. We're also leaning into the strength of our Shine campaign, layering on to the successful launch of our metallic series with a gold addition to capitalize on the holiday theme.

In closing, Coach continues to deliver with a clear strategy, unique and authentic purpose and commitment to driving sustainable, healthy growth through profit gains that fund brand building. We remain focused on fueling further momentum and are confident in the tremendous runway ahead for this iconic brand.

Now moving to Kate Spade. During the quarter, top line performance improved sequentially amid a difficult demand backdrop. Importantly, we expanded gross margin and delivered another quarter of handbag AUR gains, which fueled increases in operating profit and margin. At the same time, we continue to invest in the brand and capabilities that underpin our long-term ambition. We remain confident in our strategies and are agile, as we focus on driving enhanced innovation and financial results.

In the quarter, we advanced our strategic initiatives. First, we remain focused on building a compelling and innovative handbag offering. We launched the Dakota family in retail, which features new signature hardware. The bold and modern collection outperformed our expectations, resonating with younger consumers at an above-average AUR. Based on Dakota's initial performance, we're excited to build momentum through marketing amplification and the introduction of new styles within the family. And in outlet, we accelerated the introduction of Madison, a collection of reinvigorated Saffiano Leather styles to build out the core offering. The family outperformed plan and over-indexed with new and younger customers while also driving an increase in customer reactivation underscoring future opportunity.

Having said that, performance in carryover families declined, reinforcing our strategic decision to move with urgency to accelerate the pace of newness to drive stronger customer engagement and financial results. Touching on novelty, which continued to bring heightened emotion to the brand and build out the world of Kate Spade our Martini collection, embedded across our lifestyle categories resonated with our customer base, notably among our highest spending customers. Overall, our product initiatives, coupled with our use of data to deepen our understanding of consumer preferences, supported mid-single-digit handbag AUR growth globally, demonstrating our commitment to brand building and fueling innovation.

Next, we advanced our strategy to become more lifestyle with momentum in jewelry and footwear where we delivered double-digit top line growth. Jewelry remained an important acquisition vehicle with outsized resonance among younger consumers, while footwear outperformed on strength in loafers and sneakers as we infuse Kate

Spade's branding and codes into key styles. We know that customers who shop across categories are our highest value customers, demonstrating the importance of the brand's lifestyle offering as a long-term growth driver.

Now touching on marketing. We delivered campaigns that express the world of Kate Spade with a direct link to our product offering. In the quarter, we evolved our New York Fashion Week presentation to further engage the broader community, including our creators loft, a 3-day pop-up design to support up-and-coming Gen Z creators. Further, in keeping with our brand values, we hosted the Global Summit on Women's Mental Health and Empowerment in partnership with Pinterest, which brought together leaders from Kate Spade's Social Impact Council and key industry partners to encourage conversation, education and research around this important cause. These campaigns and engagements alongside our compelling product offering, drove an improvement in brand consideration in the U.S. compared to last year, which included notable increase among young female millennials for YouGov.

At the same time, our efforts helped to support the recruitment of over 400,000 new customers in North America alone. Next, consistent with our priority of becoming more global, we invested in brand activations across international markets to drive awareness, a key opportunity. As such, we launched experiential events supporting the introduction of Dakota including a playful giant Dakota bag in Japan, a traveling bus serving Matcha across Singapore and branded taxis, featuring our iconic green dots and stripes in the U.K. These activations successfully introduce new and younger customers to our brand.

Finally, we remain focused on the omnichannel opportunities for the brand. In October, we launched a dedicated katespadeoutlet.com site, replacing the brand's surprise site in order to provide a more cohesive way for outlet consumers to discover and shop the brand online. Importantly, the seamless launch of the site enables us to offer our customers a consistent omnichannel outlet experience across products, marketing and messaging. For the upcoming holiday shopping season, we will lean into Kate Spade positioning as a brand that embodies joy and celebration. We're launching distinctive newness in core platforms across channels. In retail, we will expand the Dakota family building on our recent success. In outlet, we will animate the Madison collection with the introduction of a Mini Duffel. We're also excited to launch our spade flower coated cannabis pattern, establishing a new signature branding platform for the channel. We also have compelling gifting and novelty assortments designed to drive differentiation and customer engagement.

In marketing, we will focus on storytelling, highlighting Kate Spade's optimistic and playful spirit true to the brand and the holiday season. In addition, we are launching physical activations of our brand codes globally while delivering content that reinforces our product strategies. Overall, we're making important progress at Kate Spade, executing with intention and agility to forge strong emotional bonds with consumers, while at the same time, driving enhanced profitability. Our go-forward strategy is clear, and we are well positioned to successfully navigate the dynamic environment in the near term while delivering on our long-term ambition for the brand.

Turning to Stuart Weitzman. Results in the quarter were pressured against the volatile external backdrop. Specifically, top line trends reflected a continued reduction in off-price wholesale shipments, as well as a slower-than-anticipated recovery in China. That said, we achieved positive wholesale trends at POS and expanded gross margin. While we are unsatisfied with the brand's performance, we are focused on prioritizing brand health and delivering innovation for consumers.

Touching on key elements of the brand's strategic growth pillars. First, during the quarter, we curated a relevant offering of emotional product. Our core collection of boots and booties drove outsized recruitment of younger customers, while at the same time, driving lapsed customer reactivation. Our expanded 50-50 family outperformed expectations as we introduced modern takes on the iconic boot, including new colorways backed by our fall campaign, which I'll touch on in a moment. Further, we continued to build out the brand's offering, notably with more seasonless casual styles and keeping with evolving consumer preferences. To this end, loafers as well as our assortment of on-trend ballet style flats resonated with consumers, highlighting potential in these relatively underpenetrated categories. And just this month, we launched a new sneaker campaign, featuring an extensive range of innovative designs, engineered to combine fashion and function, a hallmark of the brand.

At the same time, our handbag collection, while still a small portion of the assortment drove engagement with both new and existing clients at high AUR. Next, we leveraged new marketing tactics to fuel brand heat and consideration. In September, we launched the Invincibly Iconic Fall campaign centered around a nostalgic 50-50 boot and celebration of our 30th anniversary. We've employed a multipronged approach to our marketing, including utilizing an array of influencers to organically engage with consumers from He Cong to Kim Kardashian to Sofia Richie Grainge. For holiday, we will continue to drive engagement through this campaign, celebrating the brand's heritage and capitalizing on its strength in boots and booties during the peak season.

Overall, while the brand has seen continued pressure from external conditions in its core markets, the Stuart Weitzman team is focused on executing against the brand's strategic priorities building a stronger foundation with relevant assortments in new categories to deepen consumer engagement and improve profitability over the long term.

In closing, we have meaningfully advanced our strategic agenda, remaining focused on powering our iconic brands to move the consumer in an ever-changing environment. As a result, we are in a position of strength with meaningful runway for sustainable growth. Through a relentless drive to fuel brand magic and deliver for our customers, we are confident in our ability to achieve organic top and bottom line gains. Further, through the planned acquisition of Capri Holdings, we see a significant opportunity to accelerate our strategies while driving accretion to our strong stand-alone financial plan. Importantly, this combination establishes a new powerful global house of luxury and fashion brands that expand our portfolio reach across consumer segments, geographies and product categories. By bringing together 6 iconic brands with heritage in design and craftsmanship and leveraging our modern consumer engagement platform, we will drive greater innovation, consumer connectivity and cultural relevance creating superior value for our consumers, employees, communities and shareholders around the world.

We are making progress towards closing the transaction and look forward to sharing more detailed strategies for the future at the appropriate time.

With that, I'll turn it over to Scott, who will discuss our financial results, capital priorities and fiscal '24 outlook. Scott?

SCOTT A. ROE, CFO & COO, TAPESTRY, INC.: Thanks, Joanne, and good morning, everyone. Our results continue to demonstrate the benefits of our business model as well as our financial discipline and agility. In the first quarter, we drove growth across revenue, operating income and earnings despite the volatile backdrop.

Moving to the details of the quarter, beginning with revenue trends on a constant currency basis. Sales increased roughly 2% compared to the prior year when excluding a 130 basis point FX headwind. Our results were again fueled by international, which grew 7%. In Greater China, revenue rose 9% and represented growth against our prior peak levels in 2021. At the same time, we've continued to see an uptick in travel spend from Mainland China tourists with notable increases in Japan, Hong Kong, Macau, Southeast Asia and to a lesser extent Europe. While these trends have been encouraging, sales to Chinese tourists globally remain below pre-pandemic levels, representing further opportunity ahead.

In Japan, we drove continued momentum with sales growth of 12%, aided by increased of the tourist and in other Asia, revenue was roughly flat to last year as the region lapped last year's growth of over 100%. In Europe, revenue was 1% below last year, largely in line with plan. And in North America, sales were roughly flat to last year as expected. Despite the continued difficult backdrop in the region, we delivered gross and operating margin expansion, underscoring our commitment to brand health and not chasing sales.

Now touching on revenue by channel for the quarter. Our direct-to-consumer business grew 1%, fueled by low single-digit gain in stores and in wholesale, revenue was 4% ahead of prior year, reflecting growth in our full-price accounts, mostly from Coach's trial on Amazon partially offset by a strategic reduction in off-price shipments and broader wholesale market pressure in North America.

Moving down the P&L. We delivered our strongest first quarter gross margin in a decade which was ahead of our projection and 250 basis points above last year, This year-over-year expansion included 150 basis points of favorable freight expense as well as operational outperformance, fueled by net pricing improvements. SG&A rose

3% favorable to our forecast on both a dollar and rate basis, reflecting operational savings. We continue to utilize these savings to reinvest in the business through high-return initiatives, notably platform investments and brand-building activities to drive long-term growth.

Taken together, operating margin and operating income were ahead of the prior year and our expectations and our record first quarter EPS of $0.93 was ahead of our guidance and represented growth of 18%.

Moving to the balance sheet and cash flows. We ended the quarter with $639 million in cash and investments and total borrowings of $1.65 billion. Free cash flow was an inflow of $54 million, including CapEx and implementation costs related to cloud computing of $29 million. Inventory levels at quarter end were 17% below prior year reflecting our focus on disciplined inventory management as well as a lower level of in-transits given the normalization and lead times. Heading into the important holiday season, we're pleased with the makeup of our inventory and are well positioned globally.

Turning to our dividend program. Our Board of Directors declared a quarterly cash dividend of $0.35 per common share, representing $80 million in dividend payments for the quarter. For the fiscal year, we continue to expect to return approximately $325 million to shareholders through the dividend for an annual rate of $1.40 per share a 17% increase compared to last year. As a reminder, given the acquisition of Capri Holdings, we've made the strategic decision to suspend share repurchase activity.

Now moving to our guidance for fiscal '24, which is provided on a non-GAAP basis and does not include any potential impact from the planned acquisition of Capri. We are maintaining our earnings and operating cash flow outlook for the fiscal year despite forecasting a more moderate rate of sales growth and have reduced our top line guidance by approximately $175 million. This includes roughly $100 million of FX pressure on a year-over-year basis and approximately $75 million related to a more cautious outlook in Asia and North America, given the difficult demand backdrop. Despite these pressures, we are able to reiterate our fiscal '24 EPS expectations on a stronger-than-anticipated margin performance, reinforcing the benefits of our agile platform and our focus on disciplined execution and brand management.

Moving into the fiscal year in further detail. We expect revenue of approximately $6.7 billion, representing a slight increase versus the prior year on a reported basis. Excluding an FX headwind of roughly 150 basis points, we anticipate constant currency sales growth of 2% to 3%.

Turning to sales details by region at constant currency. In North America, we anticipate revenue to be in line with to slightly above last year. This forecast reflects our commitment to maintaining promotional discipline and higher margins as we manage our brands and business for the long term. In Greater China, our outlook contemplates mid-single-digit growth, led by gains in the first half as we lapped last year's COVID-related headwinds. In Japan, we expect to grow mid-single digits, while Other Asia is forecasted to increase at a low double-digit rate. And in Europe, we anticipate high single-digit growth.

In addition, our outlook assumes operating margin expansion of over 70 basis points. We anticipate gross margin gains to drive this increase, which includes a benefit from moderating freight costs. On SG&A expenses, we anticipate slight deleverage for the year, reflecting continued investments in growth driving initiatives across the portfolio. In light of the current environment, we're continuing to monitor our cost base and take proactive actions where needed.

Moving to below the line expectations for the year. Net interest expense is anticipated to be approximately $20 million. The tax rate is expected to be approximately 20% and our weighted average diluted share count is forecasted to be in the area of 235 million shares. So taken together, we continue to project EPS of $4.10 to $4.15, representing 6% to 7% growth versus last year. And finally, before contemplating any deal-related costs, we still anticipate free cash flow of approximately $1.1 billion. This includes the expectation for CapEx and cloud computing costs to be in the area of $200 million. We expect roughly half to be related to stores, renovations and relocations mostly in Asia. The balance of spend is primarily related to our ongoing digital and IT investments.

Now let me take you through the shaping of the year. We expect relatively balanced constant currency top line and operating income growth between the first and second half of the year. Our operating margin expansion in the first half is fueled by gross margin gains, while SG&A growth is expected to moderate in the second half based on the pace of investments. We continue to forecast EPS growth to be front half weighted, primarily due to the phasing of our share count and tax rate assumptions. Looking at the second quarter specifically, we expect revenue growth of approximately 2% on a constant currency basis, which excludes roughly 60 basis points of FX pressure, and we anticipate second quarter EPS to be in the area of $1.45, representing 6% to 8% growth over the prior year.

Now to outline our capital allocation priorities looking forward, which are unchanged. First, we will invest in our brands and businesses to support sustainable growth. Second, we will utilize our strong free cash flow for rapid debt repayment. We are committed to maintaining a solid investment-grade rating. To this end, we initiated a long-term leverage target of less than 2.5x on a gross debt to adjusted EBITDA basis and expect to achieve that within 2 years of the Capri transaction close.

Finally, we will return capital to shareholders through our dividend. Importantly, we believe our strong cash flow profile provides us with further opportunity for investment and capital return. Following the achievement of our leverage target, over time, we expect to increase our dividend with the goal of achieving our stated payout ratio of 35% to 40% and see the opportunity to resume share repurchases in the future.

Before closing, I wanted to touch more holistically on the planned acquisition of Capri. We believe the acquisition will drive significant value creation with immediate accretion to adjusted earnings, enhanced cash flow and strong financial returns underpinned by a compelling industrial logic that's consistent with our commitment to being disciplined financial operators. It's important to highlight that we still expect Capri to generate double-digit EPS accretion on an adjusted basis and compelling ROIC. Embedded in these expectations is the assumption that the stand-alone Capri business will generate free cash flow in the area of $500 million on a non-GAAP unsynergized basis.

Importantly, we're making progress towards transaction close. First, the shareholders of Capri Holdings Limited approved the transaction last month, satisfying one of the conditions to close. Second, we're working towards receiving all required regulatory approvals, including responding to the FTC's second request. We remain confident in our ability to complete the transaction with a close anticipated in calendar 2024, consistent with our prior outlook. Third, we expect to fund the purchase through a combination of permanent financing, term loans, excess Tapestry cash and expected future cash flow. A portion of which will be used to pay certain of Capri's existing outstanding debt. Our financing strategy will support rapid debt paydown with prepayable debt in order to achieve our stated leverage target within 24 months post close, given the combined company's strong cash flow generation.

And finally, our integration planning efforts are moving forward as planned, and we continue to project run rate cost synergies of more than $200 million achieved within 3 years of the close. Overall, we remain excited by the opportunity to expand our house of powerful brands, increasing our position in growing and durable categories with enhanced cash flow to invest in brand building, while funding debt pay down. This combination is transformational, and we are confident in our ability to execute, positioning Tapestry as a leader in innovation, talent development and shareholder return for years to come.

In closing, for the quarter, we delivered revenue growth, strong margin expansion and high teens EPS increase despite a rapidly shifting backdrop. Our differentiated and consistent performance demonstrates the strength of our brands and our business model and the disciplined execution of our talented global teams. We remain focused on delivering against our long-term priorities driving sustainable, profitable growth, strong free cash flow and shareholder returns. I'd now like to open it up for your questions.

Questions and Answers

OPERATOR: (Operator Instructions). We'll take our first question from Bob Drbul of Guggenheim Securities.

ROBERT SCOTT DRBUL, SENIOR MD, GUGGENHEIM SECURITIES, LLC, RESEARCH DIVISION: Congratulations on a nice quarter. Can you talk a little bit more around your confidence of the continued momentum at Tapestry and I think particularly at the Coach brand?

JOANNE C. CREVOISERAT: Thanks, Bob. First, I want to recognize that we delivered growth across revenue, margin and earnings, and we delivered record earnings per share in the first quarter. We are executing consistently in a volatile environment, which I think speaks to the operating discipline that we've been showing now for over 3 years. Our focus is on maintaining brand health, expanding gross margins, and delivering against our earnings commitments. And we continue to drive strong and consistent free cash flow against the dynamic backdrop. And to your point, at Coach, the brand is strong, and we're driving continued momentum behind the brand. We're delivering sales growth and margin improvement on top of already strong margins, and we see significant runway ahead.

Our team isn't thinking to next quarter and for the fiscal year, which we're confident in, we're thinking 10 years out for the Coach brand. And I think it speaks to the innovation that they're delivering, the relevance and the differentiation we're building in the market. The operational excellence, this team is building a reputation for, they're executing with agility taking the data that we have and consumer insights, and that's fueling the brand magic that Stuart Vevers and our creative teams are delivering. So we are confident into holiday and beyond.

ROBERT SCOTT DRBUL: Great. Just have a follow-up. Can you share just, I guess, an updated thinking around the deal? Any sort of more on the updates that you could actually tell us about?

JOANNE C. CREVOISERAT: Sure. Thanks, Bob. We continue to see this as a great acquisition. It is really transformational for our business and for our industry. We are adding truly iconic brands to our platform and it's extending our reach across customer segments, across geographies and product categories. And I can't think of a better home for these brands. Tapestry's platform and our disciplined operations will unlock significant value across the broader portfolio. And we are making progress, as we expected towards a calendar year '24 close. That's really unchanged from our prior outlook.

In the meantime, integration planning efforts, they're in full swing. We continue to make progress in integration planning and we remain really excited about this transaction. We're confident in the strategic and the financial rationale and the targets we've outlined. But importantly, as you can see from our performance, we are laser-focused on our existing brands and our business, and we remain confident in the runway ahead.

OPERATOR: Our next question is from Ike Boruchow of Wells Fargo.

IRWIN BERNARD BORUCHOW, MD AND SENIOR SPECIALTY RETAIL ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: So Joanne or Scott, wanted to ask about North America. So the guide for the year didn't really move that much. It was up slightly, I think, before, and now it's kind of more in line -- was in line with plan for Q1. I guess specifically embedded in that Q2 guide. What are you guys expecting for North America? Would be great to know Coach specifically in North America? And then it just seems like you guys are expecting kind of more stability in the back half. I guess I'm just the shaping of how you're thinking about that geography relative to your guide would be very helpful.

JOANNE C. CREVOISERAT: Yes. Let me start and then maybe kick it to Scott to give you some more color on our guide. But what I will say, Ike, is that our outlook for the year was incredibly balanced and we think prudent when we started. We weren't looking for a big inflection one way or the other as we started the year. We were seeing the trends in the consumer environment unfold, and we positioned our business well against those trends. As we've come into this year, we are seeing those trends develop a little differently, and we've reflected that in our outlook, but we are still very confident in terms of how we've positioned the business, positioned our inventory and positioned our innovation pipeline to speak to consumers in the world and the dynamic backdrop that exists today. But I'll pass it to Scott to give you a little more color on the numbers.

SCOTT A. ROE: Yes. I think that pretty much covers it, honestly. The trends that we see are what we projected forward, as Joanne just said, I would just point out a couple of things the continued gross margin strength in

addition to the -- while we see the demand backdrop is a little uncertain. We continue to operate the business for the quality of the sales, not chasing the last sale. You see that in the gross margin performance in the first quarter with over 100 basis points from operational gross margin. That continues into the second quarter and into the second half of the year which is one of the reasons that we can reaffirm our profit guidance even with a modest decline in the top line, which really just reflects the current trends that we're seeing in the business today.

IRWIN BERNARD BORUCHOW: Got it. And those regional growth rates you gave for the year for guide, Scott, those are all constant currency?

SCOTT A. ROE: Yes, that's right. That's right. Yes. We took about $100 million out of FX as you saw that's predominantly in the yen and RMB is where we see the biggest impact there, that $100 million.

OPERATOR: Our next question is from Lorraine Hutchinson of Bank of America.

LORRAINE CORRINE MAIKIS HUTCHINSON, MD IN EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: I wanted to shift gears to Kate Spade. It seems like when you're launching newness, it's working, it's well received. Do you think you have sufficient newness coming through the pipeline to turn sales positive this year? And then separately, any update on Kate's progress in building out their China business?

JOANNE C. CREVOISERAT: Yes. It's a great observation, Lorraine, and it's exactly right. We are making progress, but we clearly have more to do, and we're really challenging ourselves on how we can move faster. As you pointed out, as we deliver newness, it is working and innovation in the business continues to -- the customers continue to respond to the innovation we're delivering. And we just need to move faster, and we're working with speed. What we saw in the quarter was a sequential improvement in the trend. And we did that as we expanded gross and operating margin. So it's a business that we're continuing to manage to ensure we manage it in a healthy way, and we drive our growth in a healthy way. We delivered higher income, operating income year-over-year.

So we are making progress. We do see opportunity as we continue to focus on strengthening that core handbag foundation. And when I talk about moving with speed, we've pulled up our launches. We talked about accelerating Madison an outlet last quarter and that gaining traction. We also talked about pulling up and delivering a new signature platform in outlet this quarter, and we're excited about the potential that represents a signature platform for the brand, and we do expect that to -- as we build this core handbag foundation to help us drive positive growth, again, on the top line.

But again, we're maintaining healthy brands. We drove mid-single-digit handbag AUR in the quarter, and we continue to see opportunity to take those AURs higher as we build out our growth plans. So there's a lot going on at Kate Spade. We're making progress as well in building our business in China. We're doing that thoughtfully and making sure we're investing behind the brand to build awareness. At the same time, we're rolling out a new store format. We see that resonating with consumers as well as our life stuff categories, including jewelry, which is incredibly strong in China. So we have a lot of runway ahead at Kate in our current markets but as well as in China.

OPERATOR: Our next question is from Matthew Boss of JPMorgan.

MATTHEW ROBERT BOSS, MD & SENIOR ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: Great. So Joanne, on pricing power at the Coach brand, could you elaborate on drivers of the mid-single-digit AUR expansion in the first quarter, and then initiatives in place that support the further pricing opportunities ahead that you cited despite the more dynamic backdrop that you've embedded in the forecast?

And then Scott, just help us to think about the cadence of gross margin through the balance of the year? Or just any specific puts and takes that you'd want us to consider.

JOANNE C. CREVOISERAT: Yes. I'd love to go into details of the Coach brand, but I fear that I steal Todd's thunder. So why don't, Todd, I push it to you, and we're delighted with what we're seeing at Coach. Todd?

TODD KAHN, CEO & BRAND PRESIDENT OF COACH, TAPESTRY, INC.: Thank you, Joanne. Yes. I mean as you've noticed over the 3 years, we've increased our AURs by more than 30%. And I am very confident that we will continue to see AUR growth. And what gives me this confidence is what we have been doing now for a couple of years, and it's compounding, our innovation, our storytelling, our laser focused on the consumer we're going after. That gives us so much confidence in what we're doing. And what I love and what is so important about our category, yes, there's choppy environments out there, but we sell an emotional category. And given that emotion and given that our -- we're resonating with our customer, coupled with the fact that, as we've talked about in the past, there's so much white space today between where our brand fits and where traditional European luxury sits.

So even in challenging times, we have so much room. And our room is in twofold. One, it's raising the bottom, but it's also touching the top. We -- Joanne mentioned in our prepared remarks, the idle bag. The idle bag is phenomenal bag. I was in Asia very a few weeks ago, and we're chasing inventory for the idle bag. We're basing inventory for Tabby. Those are great opportunities, but we're so disciplined in our approach that I would rather be in a chase mode, maintain our gross margin and continue to deliver, and that's what you're going to see us do for the balance of the year and the years to come.

SCOTT A. ROE: And Matt, just to speak to your question on gross margin cadence. First of all, what a strong Q1 we had, right, at 250 strongest gross margin expansion that we've seen. And while -- yes, it's true that 150 basis points of that was freight. 100 of it was operational, which is all the things that Todd just talked about, right? Our continued investment in the brand focused on engagement versus just the price message, the innovation that's coming down the pipeline. All those things combined are giving us pricing power. And when you look at the full year, we said that our freight tailwinds would moderate in the second half. They don't go to 0, but it's 150 basis points. It's very significant in the first half, and it will be similar in the second quarter and then waning in the second half.

But importantly, our gross margin for the entire year, including the back half, it remains very strong because of that operational gross margin performance that we just talked about. I mean we're up in the 150 basis points kind of range for the full year. So I don't want the freight to become the message. The message is operational discipline, continuing to reinvest in the brands focused on quality of sales and engagement is driving gross margin. And that is really holding this guide together for the full year, where even on a little bit moderated top line, we're able to hold our profitability guidance. That, coupled with the expense control that we talked about, we'll start to see expense leverage in the second half which, combined with the gross margin is what allows us to hold that profitability forecast.

Balanced first half, second half operating income, really, why EPS is front-weighted is more about the shares and tax cadence as we stop the repurchase, which is going to benefit us less in the second half.

OPERATOR: Our next question is from Michael Binetti of Evercore ISI.

MICHAEL BINETTI: Congrats on a nice quarter. I just want to clarify one thing you just said to Matt's question there, Scott. You said that we're up 150 basis point range for the year. Was that referring to the total gross margin or the underlying operational portion of the gross margin that you and Todd talked about?

SCOTT A. ROE: Yes. First of all, welcome back, Michael. And secondly, yes, you had it right. It's the total gross margin for the year -- implied in the guide. We didn't actually guide to a gross margin. We did op margin, but that's how you get there.

MICHAEL BINETTI: Understood. I guess then could -- maybe we could speak to the -- I know I asked about this a little bit, but what you're embedding in the trajectory for Coach China sales 2Q and second half within the -- I know you gave us the year. And then, Joanne, you're about to own a huge share of the aspirational handbag market globally. You don't have the Capri brands in-house yet, but I know you've studied them a lot. And as you look ahead and as the acquisition comes forward here and we start to sink in, what are some of the most attractive things you see as opportunities to drive the category in the global marketplace with all 3 of these big brands on the handbag side in-house that some of the opportunities that are incremental to what you think you can do today.

JOANNE C. CREVOISERAT: Well, I think first, let me just say that we play in a very large market, right? This market is $200 billion accessories, footwear and apparel. And it is the fragmented market. And I've been in this business for more years than I'd like to probably admit on the call. And over time, in a world where consumers can get pretty much anything they want, anywhere they want, any time they want. What matters are brands. Brands matter in this marketplace. And brands matter with consumers and what consumers value has changed over time and how they shop has changed over time. And I think what we've done in the last 3 years has really positioned our business to be able to speak to consumers to win in a marketplace where brands matter and we need to reach consumers in a different way.

So we've built the capabilities and the platform to be able to do that, and we've invested behind our brands. Coach is a great example of the power of the platform where we've gotten laser-focused on our brand positioning and clarified it. We've gotten laser-focused on our target consumer and we're reaching the consumer in an omnichannel way. We're talking to them about things that matter to them and how our brands show up in their life and that is the brand heat that is driving the Coach momentum, and the team is executing really well behind that. And we're delivering really great product, leveraging all the insights from the data that we have and bringing that balance of magic and logic together to deliver really compelling product and experiences in the marketplace. And that is the platform that's scalable. We can leverage that across more brands. So we're excited for the Capri transaction to close.

Again, these are truly iconic brands. These are brands that already matter in the marketplace today. And we believe that we can improve the execution behind these brands and really take them to another level and reach consumers in a big marketplace, a crowded marketplace and a noisy marketplace, we have the capabilities to help these brands cut through.

SCOTT A. ROE: And I'll just chip in real quick, Mike, one of your China question. I think you asked about Coach China. Our China business in total, which obviously coaches the driver. We grew 9% in the first quarter. We expect mid-single digit for the full year, which would have us about flattish in the second half. We still think we'll be above 2021 levels or slightly above 2021 levels for the full year. But that's really reflecting the trends that we're seeing on the ground right now.

OPERATOR: Our next question is from Mark Altschwager with Baird.

MARK R. ALTSCHWAGER, SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: I guess, first for Scott, just a question regarding the transaction. Any changes to how you're thinking about initial revenue and EBITDA contribution from Capri Holdings, timing, magnitude of accretion just in light of the evolving macro environment. And also curious if you're willing to share any expectations you have for interest rates on the deal financing?

SCOTT A. ROE: So as you can appreciate, Mark, what I can say is very limited at this point, given where we're at. I'll just reiterate what we said at the time of the deal. Our expectations for Capri were that in our planned horizon, which is the first 3 years. We expected modest growth, kind of low single digits, with it being down in the first year this year with the most pressure in Michael Kors. Based on our assumptions, we saw and we're confident in strong accretion, immediate double-digit accretion, strong returns, et cetera. So we can't really update what we've said publicly at this point, given where we're at in the process.

As it relates to interest rates, we all see what's going on out there. There has been some upward pressure, some moderation more recently. But a couple of things I'll remind you of. Well, I can't give you any specific numbers, we did put some hedges in place on the risk-free rate. So the treasury rate, which mitigate whatever movement that you might see, and we're still confident in the overall economics of the deal. More to come on financing as time goes on.

MARK R. ALTSCHWAGER: Okay. Maybe switching gears, I guess for Scott or Joanne. The execution on gross margin really putting you in a healthy position to be able to invest. How are you thinking about the balance between

letting the gross margin flow to the bottom line versus maybe investing more aggressively in marketing to drive the top line in a tougher consumer backdrop.

JOANNE C. CREVOISERAT: I'll start by saying we're doing both. We are managing the business with strong gross margin because we won't compromise brand health. We see tremendous long-term runway for our brands, and we're thinking longer term and executing in a way that we can deliver compelling value to our consumers and continue to drive stronger gross margins. You've seen us do it this quarter, last year, and we'll continue to do that. We did it across all of our brands. And we're continuing to invest in brand building because that is the dynamic that creates the flywheel, right? As we continue to drive gross margin and expand gross margin, we're leveraging that margin expansion to invest in brand building, which then helps drive top line creates the brand heat that creates the flywheel.

So we're doing both, but we are protecting brand health. We're not going to chase every last sale. And we've been navigating what I would call a dynamic environment, but also a highly promotional environment for a while, and you've seen us operate with discipline. It includes not only just the desire and will have disciplined pricing, but it includes the data and analytics that support our SKU breadth and assortment. It includes the inventory management discipline that we've built over the last few years to make sure we've got inventory well positioned that we're responding to demand signals when we see them and connecting the back end of our supply chain to our front-end demand signal.

So there's a lot of process and system and people -- that support our ability to continue to maintain gross margin and then also, we're looking to continue to invest in our brands.

SCOTT A. ROE: Yes. Maybe just a quick build Mark. A lot of times the question that we get is, where do you see the evidence of the platforms that you've built your data and analytics capabilities, where is the evidence in the P&L? I would say in 2 areas. Number one, the ability to understand the trends in our business and the fact that we're a data business, and we use that data has helped us moderate our spending, and that's why you're going to see leverage in light of a lighter demand environment in the second half. And then secondly, it's -- we don't guess on those decisions that Joanne just mentioned. We're very thoughtful in looking at the returns as we make these investments, we don't just say we're going to invest more in our brands. We're looking at those returns, we're leaning in where they work or leaning back where they don't. And that discipline is helping us to I think, have a high-quality P&L in a very tough environment right now. And the last proof point is our inventory, right, down 17%. Most of that's in transit, but the combination of strong gross margins and really well-positioned inventory, I think, is just a testament of the insights that we're getting into the business and the discipline that you see.

OPERATOR: Our next question is from Brooke Roach with Goldman Sachs.

BROOKE SILER ROACH, RESEARCH ANALYST, GOLDMAN SACHS GROUP, INC., RESEARCH DIVISION: Can you elaborate on what you're seeing with consumer engagement in North America by brand across outlet versus full line and also household income cohort? What changes have you seen in the consumer environment that are developing differently than your prior outlook? And are you seeing any signs of increased price sensitivity among consumers in North America?

JOANNE C. CREVOISERAT: Great question, Brooke. North America is -- we're operating in a more challenging environment. Our -- having said that, our first quarter results were flattish to last year, which was a meaningful sequential improvement from the fourth quarter, and it was in line with our expectations as we came into the quarter. But to your question, the aspirational consumer, that lower income cohorts -- I would say this is across channels. We're not seeing major distinction between our channels, across channels. The aspirational consumer is under more pressure on a relative basis. They're being more choiceful. But again, that hasn't materially changed from Q4.

As a business, we're focused on the controllables. We're focused, as we just talked about on brand building, delivering product excellence to Lorraine's question, when we deliver innovation and newness, we see the consumer respond. And we're focused on strong execution. So we're delivering that newness. We're delivering that

innovation across our brands. You saw it with the Coach Shine campaign, and the Coachtopia rollout, the icons at Kate that we're rolling out. And even the launch of sneakers at Stuart Weitzman, really responding with innovation to what we're hearing and seeing from the consumer, and we're managing the business in a healthy way. We'll continue to expand AUR and gross margin. I'm sorry, go ahead, Todd.

TODD KAHN: No, no, sorry. I just quickly add, Brooke. I mean globally, we -- our direct business was up. North America was up. And we feel good because, again, it goes back to the emotion and the connection we're making with the consumer. And by way of example, even in value channel, we're introducing more Tabby bags directly at full price because it's just a point of distribution. And we're seeing that in North America resonate, and we're going to roll that out over time to more and more doors. So it's very interesting. We're finding some time even the young cohort might come into the Coach brand buying (inaudible). That might be the first thing they buy, they might even buy it at one of our value channels. Then they end up buying a Tabby bag.

So this concept of one Coach of this desirability that we're creating, that people are coming in into an outlet store with the image of the Coach Tabby bag and wanting that. That, to me, creates so much more desire across all value channels and full price channel.

BROOKE SILER ROACH: Great. And if I could just ask one quick follow-up. I'm curious what you think the health of the industry, it looks like in North America between wholesale and DTC? Understood that you currently don't have much wholesale exposure, but like the pre portfolio does. And I'm curious what your thoughts are about the ongoing run rate momentum of those 2 channels as you look ahead?

JOANNE C. CREVOISERAT: Well, we have seen, I think, in North America and the market generally more pressure in the wholesale channel over the last year. That's not something new. To your point, our business is roughly 90% direct. And we like that direct relationship that we have with the consumer. It allows us to understand and see trends faster as they're happening. There is a reason to have wholesale. I think they're wholesale, and we appreciate the partners that we have in the wholesale market that provide exposure of the brand to a broader base of consumers. But again, we like the direct relationship that we have with our consumers. We've worked to build our platform to be able to reach consumers as their shopping habits evolve. And our focus is really following the consumer. And I would say we see an opportunity to build the direct business with the Capri brands. That's something that our platform will provide, and we see runway ahead.

TODD KAHN: And the one thing I will add again, as Joanne said, we love our direct -- is we love our wholesale partners that we're in. I'm looking forward to the opportunities that may come to enhance wholesale in a selective way when we take -- we have the leverage of multiple brands. So I think that's going to be a benefit to the consumer and the benefit to our wholesale partners.

OPERATOR: And we'll take our final question from Oliver Chen with TD Cowen.

OLIVER CHEN, MD & SENIOR EQUITY RESEARCH ANALYST, TD COWEN, RESEARCH DIVISION: A lot of premium luxury brands are not on Amazon. Just what was your philosophy for that? And Amazon can also often employ variable pricing and think about brands differently. Also the sales decline in digital, just what's underpinning that, we've seen tougher performance marketing online. And then lastly, on thinking about the second request, diversion ratio, suitability as well as the outlet channel. Those may be topics and focus? Any thoughts on catalysts around the second would be helpful as well.

TODD KAHN: I guess you have the question for every one of us.

JOANNE C. CREVOISERAT: Yes. Go ahead, Todd, I'll let you kick it off.

TODD KAHN: I'll do the Amazon one. And that's it. Thank you.

JOANNE C. CREVOISERAT: I'll pick up digital.

TODD KAHN: Okay. Oliver, it's interesting. We did a lot of due diligence on Amazon. And we talk a lot at the Coach brand about being consumer offset. And through that due diligence and through this trial that we've launched with Amazon, we recognize, particularly with the young consumer that the journey, the discovery, the particularly of fashion brands and our category starts at Amazon. And we've been on Amazon. And one of the things that I love with this trial that we're working with Amazon is we opened up a beautiful brand-enhancing shop on Amazon. We're learning. We're using their technology. Their 3D technology alone is fascinating in terms of showing the functionality and the desirability of our product. They've been a very good partner. It's a wholesale relationship. And to date, we've seen no cannibalization. So again, when you put things through a consumer lens and say, how does the consumer see a brand, how do you create desirability, how do you create accessibility. This looks like a pretty great start for us, and we're happy with the performance we've seen.

JOANNE C. CREVOISERAT: And on digital, Oliver, I'll take the next 2 parts of your question. On digital, our focus is on driving engagement with the consumer and meeting them where they are. And we still believe that digital is an important part of the consumer journey. In the quarter, we saw slight declines in digital, but our penetration in digital remains basically in line with where it was last year at 25%, still triple where it was pre-pandemic. So we've built this digital scale and the digital business, and we're available to customers to transact absolutely online, but they're leveraging our digital channel for more than just the transaction, and we believe it's important to maintain those capabilities. And we'll follow the consumer. We're happy to meet consumers in stores. We have great field teams and we have a highly profitable store fleet, and we have a highly profitable digital channel. So we're agnostic as to where they shop, and we're available to meet them, and we continue to improve the experience in the digital space to make sure that consumers receive a seamless experience and a really great brand experience that it becomes a -- and continues to be a great touch point for the brand.

If they're just discovering and choose to go into a store to finalize that transaction, we want to be there for them, and we continue to improve our game in digital. We see it as critically important moving forward. And then on the regulatory front, we are working to receive all the required regulatory approvals, including -- and that includes, as you saw, responding to the FTC second request. Our outlook for closing the deal is unchanged. We still expect to close the deal in fiscal '24. And as you know, we operate in a large market, as I talked about, it's the $200 billion market. It's fragmented. There are low barriers to entry and the transaction is pro-consumer. So we remain confident in our ability to complete the transaction, again, closing expected in calendar '24, consistent with our prior expectations.

OPERATOR: Thank you. That concludes our question-and-answer session. I will now turn it over to Joanne for some concluding remarks.

JOANNE C. CREVOISERAT: Well, thank you for joining us today and for your interest in our story, and thank you to our passionate teams around the world that make these results happen. Our strong and consistent results reinforce the power of our brands, our strategies and our agile operating model, which enable us to continue to deliver for our customers against the dynamic backdrop. Moving forward, I'm confident in our organic runway, and look forward to accelerating our strategic and financial results through the acquisition of Capri Holdings.

At Tapestry, we are focused, and we have a relentless drive to lead in innovation and shareholder returns for years to come. Have a great day.

OPERATOR: This concludes Tapestry's earnings conference call. We thank you for your participation.

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Load-Date: November 21, 2023

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